



Legislative Audit Division

Performance Audit Summary

Petroleum Tank Release Compensation Fund

November 2003

Introduction

The Legislative Audit Committee (LAC) requested a performance audit of the Petroleum Tank Release Compensation Fund (Petrofund) and regulation of underground storage tanks (UST). Petrofund was established in 1989 to pay for allowable costs associated with releases from petroleum storage tanks. It is funded through a tax on distribution of petroleum products. Fund administration is a joint responsibility of the Petroleum Tank Release Compensation Fund Board (the Board) and the Department of Environmental Quality (DEQ).

Program Funding

Petrofund has three programs associated with its operations; compliance, cleanup and compensation. The compliance program is funded primarily through tank registration fees and permit fees. Annual revenues from tank registration, licensing, and permitting fees are around \$330,000. The cleanup and compensation programs are funded through Petrofund. Annual fund revenues are around \$6.2 million. To date, Petrofund has paid approximately \$58 million in cleanup compensation.

Fund Solvency

Montana's Petrofund is similar to models used in other states. Petrofund fulfills two functions:

- **Compensation:** fund revenues are distributed as payments to eligible tank owner/operators undertaking cleanup of a petroleum release.
- **Ability to Pay:** the fund provides the assurance required by law that the owner/operator has the financial ability to pay cleanup costs.

There must be sufficient monies present in the fund to meet financial obligations. For the compensation function, the fund should, on a continuing basis, contain sufficient monies to pay cleanup costs during any given time period.

Ability to pay involves maintaining a reserve capacity to cover liabilities. Federal regulations (40 CFR 280.93) and Montana statute (section 75-11-307, MCA) define the annual aggregate liability limit for most tank owner/operators at \$1 million. Because Petrofund can be used by all eligible tank owner/operators in the state, there is a high level of exposure to potential loss.

The Trend Towards Insolvency

Petrofund posted a negative fiscal year-end fund balance on one occasion. For four out of seven years, the fiscal year-end balance was below \$1 million. The fund balance has declined in two stages driven by operational deficits in FY 1992 and 1993, and again in FY 1995, 1996, and 1997. Failure to arrest the trend towards insolvency could result in delays in compensation payments to tank owner/operators and could also adversely affect facility compliance status under federal/state ability to pay requirements. There could also be negative environmental and human health consequences if resources are not available for cleanup.

Board Duties and Responsibilities

Statute identifies the Board as the entity responsible for fund administration. Seven members are appointed for three-year terms by the Governor and include representatives from the petroleum industry and other private sector groups. The Board could play a more active role in managing liabilities and promoting fund solvency. *Statute establishing the Board's role should be revised to reflect a proactive approach to managing liabilities.* Following analyses of biennial fund activity, the Board could report to the governor and legislature on the effectiveness of the fund and the need for changes to reduce exposure to liabilities.

Designated Petrofund Responsibilities

The board and the department are both involved in Petrofund eligibility determinations, cleanup, and compensation. Over the years, these roles and responsibilities became intermeshed. For example, Petrofund eligibility determinations are dependent on input from four different departmental entities, in addition to the Board. Cleanup and compensation review is dependent on opinions from staff in two different departmental units. Similarly, compensation approval is subject to a review by two department units, as well as approval by the Board.

The overlap of responsibilities has a detrimental effect on controlling costs and liabilities. The impact is seen in two areas: (1) extensive timeframes for processing claims, and (2) increased administrative costs. A number of responsibilities should be reassigned.

Delegating eligibility responsibilities to Board staff should streamline the process and allow the Board to spend more time actively managing fund solvency.

The department should assign sole responsibility for cleanup action to a single entity. This responsibility should be separate and distinct from any cost estimate review or compensation determination. ***The department should also reassign compensation responsibilities from the Remediation Division to the Financial Services office.*** Reassigning the responsibilities reinforces the functional boundary between cleanup and compensation.

Department compliance functions relating to UST permitting are assigned to the Remediation Division. The Remediation Division's process controls are focused on cleanup and are not well adapted to the compliance function. ***The benefits of reassigning UST compliance and permitting functions to the Permitting and Compliance Division include improvements in operational efficiency and program performance derived from the shared use of common resources and the accessibility of relevant expertise and experience.***

Define and Standardize Corrective Action Procedures

Corrective action plans submitted to the department outline cleanup actions and associated costs. DEQ staff review and approve these plans prior to compensation. In order to be eligible for compensation, owner/operators must initiate actions outlined in an approved plan from the time of discovery until the release is resolved.

There are a wide range of formats and contents for corrective action plans. Lack of standardization appears to increase corrective action plan review time. ***Pre-defined remediation tasks should streamline the plan approval process by providing clear review parameters. Establishing a standardized format should also improve staff efficiency during plan review and reduce the length of time needed for corrective action approval.***

Revise Petrofund Compensation Procedures

Compensation involves department staff reviewing and approving claimed amounts to ensure costs are reimbursable under the criteria defined in law. The department's approach to compensation does not ensure efficient or effective cost control. Staff determines reasonableness for individual invoice items on a time and materials basis rather than on a unit cost basis.

Funds in other states responded to the need for cost controls by developing unit costs for defined cleanup tasks and setting a maximum dollar value payable for the task. This is a reasonable cost ceilings approach. Using this approach should reduce processing times, department administrative costs, and claimant business costs.

The Board and the department agree on the need to move forward with reasonable cost ceilings. The Board should establish a timetable for implementation of the approach.

The Future of Petrofund

Petrofund was developed in response to specific circumstances. The fund's design and operation were determined by conditions that existed before regulatory efforts made a significant impact on the problem of releases. Petrofund was also created when private financial assurance was unavailable or unaffordable. ***Circumstances have changes.***

The design of underground storage tanks has improved, reducing the risk of releases. Improvements in technology do not necessarily lessen the severity of releases, but they do ensure fewer releases and reduce liability. ***Compliance efforts resulted in 96 percent of tanks meeting all upgrade requirements and all USTs in the state are now subject to regular inspections.*** Due to the successful compliance effort, new releases are declining and appear to be stabilizing at around 50 per year. Petrofund has assumed liability for a large portion of historic contamination.

Private insurance coverage is now more available and affordable. The market for UST insurance has been growing as changes in tank design and state compliance efforts have reduced release risk and existing contamination has been mitigated by state fund activities. ***Previous barriers to purchasing UST insurance no longer exist.***

The Future of Petrofund

The cleanup fee was originally set at \$0.0075 per gallon and has remained at this level. As long as the state continues to assume liability, collection of the cleanup fee will be necessary. ***Transferring liabilities to the private sector would allow for the gradual reduction and eventual elimination of the tax.***

Making the Transition

Circumstances have changed since the early 1990s when state-sponsored financial assurance was the only option. ***The Legislature should outline the steps to transition from Petrofund to private insurance coverage.*** Seven other states have already completed the transition.

Tank owner/operators will find private insurance coverage a suitable replacement for Petrofund, but statute should continue to recognize alternative financial assurance mechanisms. The extent of existing liabilities will affect the timeframe for transition. Tax revenues may be required for 10 to 15 years to fund these liabilities. The legislature should consider options that will ease the transition into full private coverage, including interim reinsurance/excess coverage. By providing reinsurance for private UST insurers, the state can help promote the development of a competitive market, while mitigating the impact of new premium costs for tank owner/operations.

For a complete copy of the report (02P-09) or for further information contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at <http://leg.mt.gov/audit>.